DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION ON AVERAGE BALANCES—Continued

Year	Asset balance Jan. 1	Current additions	Current retirements	Asset balance Dec. 31	Average balance	Rate (percent)	Allowable depreciation
1955	$12,000	....	....	12,000	12,000	18.67	2,240
1956	12,000	....	....	12,000	12,000	18.67	2,240
1957	12,000	....	$2,000	10,000	11,000	18.67	2,054
1958	10,000	....	2,000	8,000	9,000	18.67	1,680
1959	8,000	10,000	4,000	14,000	11,000	18.67	2,054
1960	14,000	....	2,000	12,000	13,000	18.67	2,427
1961	12,000	....	2,000	10,000	11,000	18.67	2,054

CORRESPONDING DEPRECIATION RESERVE ACCOUNT

Year	Depreciation reserve Jan. 1	Depreciation allowable	Current retirements	Salvage realized	Depreciation reserve Dec. 31
1954	....	$1,120	....	....	$1,120
1955	$1,120	2,240	....	....	3,360
1956	3,360	2,240	....	....	5,600
1957	5,600	2,054	$2,000	$200	5,854
1958	5,854	1,680	2,000	200	5,734
1959	5,734	2,054	4,000	400	4,188
1960	4,188	2,427	2,000	....	4,615
1961	4,615	2,054	2,000	....	4,669

§ 1.167(b)–2   Declining balance method.

(a) *Application of method.* Under the declining balance method a uniform rate is applied each year to the unrecovered cost or other basis of the property. The unrecovered cost or other basis is the basis provided by section 167(g), adjusted for depreciation previously allowed or allowable, and for all other adjustments provided by section 1016 and other applicable provisions of law. The declining balance rate may be determined without resort to formula. Such rate determined under section 167(b)(2) shall not exceed twice the appropriate straight line rate computed without adjustment for salvage. While salvage is not taken into account in determining the annual allowances under this method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value. However, see section 167(f) and § 1.167(f)–1 for rules which permit a reduction in the amount of salvage value to be taken into account for certain personal property acquired after October 16, 1962. Also, see section 167(c) and § 1.167(c)–1 for restrictions on the use of the declining balance method.

(b) *Illustrations.* The declining balance method is illustrated by the following examples:

Example (1). A new asset having an estimated useful life of 20 years was purchased on January 1, 1954, for $1,000. The normal straight line rate (without adjustment for salvage) is 5 percent, and the declining balance rate at twice the normal straight line rate is 10 percent. The annual depreciation allowances for 1954, 1955, and 1956 are as follows:

Year	Basis	Declining balance rate (percent)	Depreciation allowance
1954	$1,000	10	$100
1955	900	10	90
1956	810	10	81

Example (2). A taxpayer filing his returns on a calendar year basis maintains a group account to which a 5 year life and a 40 percent declining balance rate are applicable. Original investment, additions, retirements, and salvage recoveries are the same as those set forth in example (3) of paragraph (b) of § 1.167(b)–1. Although salvage value is not taken into consideration in computing a declining balance rate, it must be recognized and accounted for when assets are retired.

DEPRECIABLE ASSET ACCOUNT AND DEPRECIATION COMPUTATION USING AVERAGE ASSET AND RESERVE BALANCES

Year	Asset balance Jan. 1	Current additions	Current retirements	Asset balance Dec. 31	Average	Average reserve before depreciation	Net depreciable balance	Rate (pct.)	Allowable depreciation
1954	....	$12,000	....	$12,000	$6,000	....	$6,000	40	$2,400
1955	$12,000	....	....	12,000	12,000	$2,400	9,600	40	3,840
1956	12,000	....	....	12,000	12,000	6,240	5,760	40	2,304
1957	12,000	....	$2,000	10,000	11,000	7,644	3,356	40	1,342
1958	10,000	....	2,000	8,000	9,000	7,186	1,814	40	726
1959	8,000	10,000	4,000	14,000	11,000	5,212	5,788	40	2,315
1960	14,000	....	2,000	12,000	13,000	4,727	8,273	40	3,309
1961	12,000	....	2,000	10,000	11,000	6,036	4,964	40	1,986

DEPRECIATION RESERVE

Year	Reserve Jan. 1	Current retirements	Salvage realized	Reserve Dec. 31, before depreciation	Average reserve before depreciation	Allowable depreciation	Reserve Dec. 31, after depreciation
1954	....	....	....	....	....	$2,400	$2,400
1955	$2,400	....	....	$2,400	$2,400	3,840	6,240
1956	6,240	....	....	6,240	6,240	2,304	8,544
1957	8,544	$2,000	$200	6,744	7,644	1,342	8,086
1958	8,086	2,000	200	6,286	7,186	726	7,012
1959	7,012	4,000	400	3,412	5,212	2,315	5,727
1960	5,727	2,000	....	3,727	4,727	3,309	7,036
1961	7,036	2,000	....	5,036	6,036	1,986	7,022

Where separate depreciation accounts are maintained by year of acquisition and there is an unrecovered balance at the time of the last retirement, such unrecovered balance may be deducted as part of the depreciation allowance for the year of such retirement.

Thus, if the taxpayer had kept separate depreciation accounts by year of acquisition and all the retirements shown in the example above were from 1954 acquisitions, depreciation would be computed on the 1954 and 1959 acquisitions as follows:

1954 ACQUISITIONS

Year	Asset balance Jan. 1	Acquisitions	Current retirements	Asset balance Dec. 31	Average balance	Avg. reserve before depreciation	Net depreciable balance	Rate (percent)	Allowable depreciation
1954	....	$12,000	....	$12,000	$6,000	....	$6,000	40	$2,400
1955	$12,000	....	....	12,000	12,000	$2,400	9,600	40	3,840
1956	12,000	....	....	12,000	12,000	6,240	5,760	40	2,304
1957	12,000	....	$2,000	10,000	11,000	7,644	3,356	40	1,342
1958	10,000	....	2,000	8,000	9,000	7,186	1,814	40	726
1959	8,000	....	4,000	4,000	6,000	5,212	788	40	315
1960	4,000	....	2,000	2,000	3,000	2,727	273	40	109
1961	2,000	....	2,000	....	1,000	836	164	....	[1] 164

[1] Balance allowable as depreciation in the year of retirement of the last survivor of the 1954 acquisitions.

DEPRECIATION RESERVE FOR 1954 ACQUISITIONS

Year	Reserve Jan. 1	Current retirements	Salvage realized	Reserve Dec. 31, before depreciation	Average reserve before depreciation	Allowable depreciation	Reserve Dec. 31, after depreciation
1954	....	....	....	....	....	$2,400	$2,400
1955	$2,400	....	....	$2,400	$2,400	3,840	6,240
1956	6,240	....	....	6,240	6,240	2,304	8,544
1957	8,544	$2,000	$200	6,744	7,644	1,342	8,086
1958	8,086	2,000	200	6,286	7,186	726	7,012
1959	7,012	4,000	400	3,412	5,212	315	3,727
1960	3,727	2,000	....	1,727	2,727	109	1,836
1961	1,836	2,000	....	(164)	836	164	....

1959 ACQUISITIONS

Year	Asset balance Jan. 1	Acquisition	Asset balance Dec. 31	Avg. balance	Reserve Dec. 31, before depreciation	Net deprecia-ble balance	Rate percent	Allowable depreciation	Reserve Dec. 31, after depreciation
1959	....	$10,000	$10,000	$5,000	None	$5,000	40	$2,000	$2,000
1960	$10,000	....	10,000	10,000	$2,000	8,000	40	3,200	5,200
1961	10,000	....	10,000	10,000	5,200	4,800	40	1,920	7,120

In the above example, the allowable depreciation on the 1954 acquisitions totals $11,200. This amount when increased by salvage realized in the amount of $800, equals the entire cost or other basis of the 1954 acquisitions ($12,000).

(c) *Change in estimated useful life.* In the declining balance method when a change is justified in the useful life estimated for an account, subsequent computations shall be made as though the revised useful life had been originally estimated. For example, assume that an account has an estimated useful life of ten years and that a declining balance rate of 20 percent is applicable. If, at the end of the sixth year, it is determined that the remaining useful life of the account is six years, computations shall be made as though the estimated useful life was originally determined as twelve years. Accordingly, the applicable depreciation rate will be 16⅔ percent. This rate is thereafter applied to the unrecovered cost or other basis.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6712, 29 FR 3653, Mar. 24, 1964]

§ 1.167(b)–3 Sum of the years-digits method.

(a) *Applied to a single asset*—(1) *General rule.* Under the sum of the years-digits method annual allowances for depreciation are computed by applying changing fractions to the cost or other basis of the property reduced by estimated salvage. The numerator of the fraction changes each year to a number which corresponds to the remaining useful life of the asset (including the year for which the allowance is being computed), and the denominator which remains constant is the sum of all the years digits corresponding to the estimated useful life of the asset. See section 167(c) and § 1.167(c)–1 for restrictions on the use of the sum of the years-digits method.

(i) *Illustrations.* Computation of depreciation allowances on a single asset under the sum of the years-digits method is illustrated by the following examples:

Example (1). A new asset having an estimated useful life of five years was acquired on January 1, 1954, for $1,750. The estimated salvage is $250. For a taxpayer filing his re-

turns on a calendar year basis, the annual depreciation allowances are as follows:

Year	Cost or other basis less salvage	Fraction[1]	Allowable depreciation	Depreciation reserve
1954	$1,500	5/15	$500	$500
1955	1,500	4/15	400	900
1956	1,500	3/15	300	1,200
1957	1,500	2/15	200	1,400
1958	1,500	1/15	100	1,500
Unrecovered value (salvage)	....	....	....	$250

[1] The denominator of the fraction is the sum of the digits representing the years of useful life, i.e., 5, 4, 3, 2, and 1, or 15.

Example (2). Assume in connection with an asset acquired in 1954 that three-fourths of a year's depreciation is allowable in that year. The following illustrates a reasonable method of allocating depreciation:

	Depreciation for 12 months	Allowable depreciation		
		1954	1955	1956
1st year	$500	(¾) $375	(¼) $125	....
2d year	400	....	(¾) 300	(¼) $100
3d year	300	....	....	(¾) 225
Total		375	425	325

(ii) *Change in useful life.* Where in the case of a single asset, a change is justified in the useful life, subsequent computations shall be made as though the remaining useful life at the beginning of the taxable year of change were the useful life of a new asset acquired at such time and with a basis equal to the unrecovered cost or other basis of the asset at that time. For example, assume that a new asset with an estimated useful life of ten years is purchased in 1954. At the time of making out his return for 1959, the taxpayer finds that the asset has a remaining useful life of seven years from January 1, 1959. Depreciation for 1959 should then be computed as though 1959 were the first year of the life of an asset estimated to have a useful life of seven years, and the allowance for 1959 would be 7/28 of the unrecovered cost or other basis of the asset after adjustment for salvage.

(2) *Remaining life*—(i) *Application.* Under the sum of the years-digits